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SUBJECT: SCENESETTER FOR SECRETARY OF STATE RICES' JUNE 4 VISIT TO PANAMA

This message is sensitive but unclassified. Please protect accordingly.

11. (SBU) Welcome and Summary. Embassy Panama extends a warm welcome to you and your delegation. Your engagement in Panama can help strengthen our excellent bilateral relationship, solidify support for the U.S.-Panama Trade Promotion Agreement (TPA), reinforce U.S. support for, and interest in, the \$5.25 billion Panama Canal expansion project, and advance broader U.S. economic and social interests. Your visit comes at a time when Panama enjoys an economic boom while, at the same time, it endeavors to overcome stubbornly high levels of poverty, yawning income disparities, high unemployment, widespread corruption, and poor educational and healthcare systems. Public support nonetheless remains solid for both the Torrijos Administration and the TPA. Panamanians have noted that the FY08 elimination of U.S. foreign assistance for Panama will end our direct assistance for good governance programs, anti-corruption efforts, and other basic development work. You will:

- have the opportunity address the Organization of American States General Assembly (OASGA);
- hold informal discussions over lunch and in a private dialogue with FMs and other leaders from this hemisphere's thirty-four countries;
- hold separate bilateral meetings with the Peruvian FM and the Ecuadoran FM;
- meet with Panamanian President Martin Torrijos; and
- conduct two television interviews with U.S. Spanish-language outlets.

Your visit follows President Bush's March 2007 Latin America tour and President Torrijos' February 2007 Washington visit. Your visit will also come on the heels of Transportation Secretary Mary Peters' May 6-9 visit and Deputy Secretary of State John Negroponte's May 11 visit. Deputy U.S. Trade Representative John Veroneau visited Panama March 15-16. While Secretary of Health and Human Services Mike Leavitt will also be traveling with you, he will engage in a separate program in Panama. CODEL Skelton will also be in Panama during your visit for bilateral discussions on security matters, and CODEL Meeks will have departed the day before your arrival. End Summary.

Panama Sees Boom in GDP and Investment

12. (U) With 8.1% GDP growth in 2006, Panama's economy saw its fastest growth in 14 years, topping solid levels of 6.9% in 2005 and 7.5% in 2004. Panama's dollarized \$15 billion/year economy is based primarily on a well-developed services sector that accounts for roughly 80% of GDP. Services include the Panama Canal, banking and financial services, legal services, container ports, the Colon Free

Zone (CFZ), and flagship registry. The Panama Canal accounts for approximately 5% of Panama's GDP directly, and between 23% and 35% indirectly. The maritime industry accounts for approximately 20% of Panama's GDP.

13. (U) The GOP estimates that inflows of Foreign Direct Investment (FDI) exceeded \$2.4 billion in 2006, more than double that of 2005. However, this result was skewed by HSBC's \$1.8 billion purchase of Banistmo (Panama's largest bank) in November 2006. The stock of U.S. FDI in Panama, which currently totals about \$5.2 billion, is concentrated primarily in the maritime, energy, and financial sectors. Growing numbers of U.S. and other foreign retirees have helped drive Panama City's skyline upward, boosted the country's impressive construction boom over the past several years, and prompted closer ties between U.S. and Panamanian real estate industries. Although the GOP has tightened its banking supervision considerably over the past decade, money laundering remains an ongoing challenge and is increasingly of concern in other sectors, such as real estate and the gaming industry.

14. (U) Panama also maintains one of the most liberalized trade regimes in the hemisphere. The U.S. is Panama's largest trade partner, with two-way trade reaching nearly \$3.1 billion in 2006, an increase of 24% over 2005's trade of nearly \$2.5 billion. With 2006 exports of \$2.7 billion and imports \$378 million, the U.S. continued to maintain its huge trade surplus with Panama. Panama has existing free trade agreements in place with El Salvador, Taiwan, and Singapore, as well as partial trade agreements with Mexico, Colombia, and the Dominican Republic. In December 2006, the National Assembly unanimously approved a bilateral free trade deal with Chile. On March 1, 2007 Panama and Honduras concluded their FTA negotiations. Panama continues to negotiate separate FTAs with Costa Rica, Guatemala, and Nicaragua.

Persistent Poverty, Unemployment, Corruption and Lack of Skilled Labor Cloud the Horizon

15. (SBU) At \$4,600, Panama's per capita GDP ranks among Latin America's highest. President Torrijos hopes that sustained growth resulting from the Panama Canal expansion project and the TPA will help push Panama into "first world" status. However, neither the Canal nor the TPA is a panacea, as cronyism and weak institutions (especially the notoriously corrupt judiciary and troubled health and education sectors) have kept Panama's solid GDP growth from translating into broadly shared prosperity. Panama is second only to Brazil in having Latin America's worst income distribution. Poverty persists at nearly 40% overall (higher than 80% in some rural areas), and unemployment remains high (officially about 8.6%, with more than 20% underemployed) despite showing some signs of improvement in the past two years. The Embassy is focused on working with Panamanians to promote good governance and to help them better address the risks posed by public mismanagement, corruption, and persistent urban poverty and hopelessness. With the FY08 elimination of U.S. foreign assistance for Panama, our USAID mission has begun to plan for an orderly close-out of its programs, including those that have helped to promote good governance, empowered anti-corruption NGOs, advanced sustainable development, and boosted trade capacity building for small and medium-sized businesses.

16. (SBU) Corruption is widespread in the Panamanian judiciary. Despite campaign promises by President Torrijos to eradicate corruption, there have been no significant indictments or prosecutions for official corruption. In December 2005, the USG revoked the visa of sitting Panamanian Supreme Court Justice Winston Spadafora. In September 2000, the USG revoked the visa of ex-President Ernesto Perez Balladares.

17. (SBU) Despite spending 12% of the national budget and 5% of GDP on education, Panama suffers from a poorly educated workforce. About half of prospective University of Panama students recently failed their entrance exams, prompting university authorities to lower the threshold for entrance. Acutely aware of the political blow-up the could result from filling the Panama Canal expansion

project with skilled foreign workers, the GOP is spending \$85 million to train Panamanian workers hoping to work on the project. However, about one-third the training program's applicants cannot begin the program because they lack the basic literacy and math skills required.

U.S.-Panama TPA Enjoys Solid 62% Support

¶18. (U) On December 19, 2006, the USG and GOP announced closure of TPA negotiations subject to resolution of certain labor issues. On March 30, 2007, President Bush notified Congress of the administration's intent to sign the TPA. USTR and Congressional leaders recently agreed on the labor portion of the TPA, opening the way for a signing in late June. .

¶19. (U) Following the December 19, 2006 closure of TPA negotiations in Washington, the GOP intensified its campaign to promote the agreement throughout the country, touting the TPA as the "best deal" negotiated by a Latin American country with the U.S. Through an aggressive media campaign and hundreds of seminars with business chambers, labor unions, civic groups, and communities around the country, the GOP has gained the support of 62% of Panamanians. This is substantially higher than the 39% level of support reported in a May 2006 poll. (Note: The 2006 poll reflected uncertainties and fears generated by former Agriculture Minister Laurentino Cortizo's flamboyant resignation at the outset of the ill-fated ninth round of negotiations in January 2006.)

¶10. (SBU) Despite some anti-TPA noise from extreme left-wing quarters, TPA opponents are currently sparse and disorganized. Since December, leaders of various political opposition parties have told Embassy officers that they expect Panama's National Assembly to pass the deal by a wide margin. One prominent opposition party leader noted that virtually all business sectors have lined up for the TPA and that any politician opposed to the agreement would fear being associated with Panama's most extreme leftists. Moreover, many of Panama's political leaders also have business interests that stand to benefit from the TPA.

\$5.25 Billion Panama Canal Expansion Gets Underway

¶11. (U) Since the December 31, 1999 handover of the Panama Canal by the U.S., the Panama Canal Authority (ACP) has proven itself an able administrator, turning the Panama Canal into an efficient and profitable business. During the past five years, the ACP has reduced average Canal transit times, accidents in Canal waters, and has overseen large-scale upgrade and maintenance projects. The ACP also has tripled Canal revenues since the handover, topping \$1.5 billion in 2006. In 2006, the ACP remitted to the national government \$570 million. To protect the Canal's vital water resources, the Panama Canal Authority (ACP) has matched a \$2.5 million fund that USAID put in place to better manage the Canal watershed.

¶12. (SBU) In October 2006, Panamanians voted overwhelmingly (78% to 22%) in favor of the proposed expansion of the Panama Canal. This project is due for completion in 2014 and will entail primarily construction of a "third lane" and two new sets of locks. The GOP expects the project will be a transforming event for Panama that will provide jobs and set the tone economically for years to come. Given growing trade between East Asia and the U.S. eastern seaboard, the expansion is central to maintaining the Canal's future viability. The ACP plans to finance the project through a

combination of Canal revenues, increased tolls, and \$2.3 billion in bridge loans. The Embassy has consistently stressed the USG's desire for clear and transparent contracting rules that offer fair opportunities to U.S. bidders. Bidding on the construction manager contract is scheduled for third quarter of 2007. This contract will account for approximately 50% of the entire project cost. Prospective bidders worry that Panama has nowhere near the number of skilled workers necessary for the expansion project, particularly English-speaking workers.

¶13. (U) On February 2, 2007, the ACP announced toll increases of 10% over the next three years commencing in July 2007. Chile, Peru, Japan and Ecuador have vigorously opposed the toll increases. The ACP pricing policy is to charge what it perceives to be the market value of its services.

Health Diplomacy: HHS-GOP Launch Regional Center

¶14. (SBU) HHS Secretary Leavitt and Panamanian Health Minister Camilo Alleyne have gained solid support from Central American partners to create in Panama the "Regional Healthcare Training Center" announced by President Bush in March 2007. Although this Center is to be formally inaugurated on June 4, HHS and Alleyne successfully launched its first course on April 16, drawing more than 50 participants from the region for training on Avian Flu preparedness and response. HHS has devoted \$4 million and the GOP \$1.5 million to lay the groundwork for what HHS and the GOP envision as a permanent, hemispheric training center for community health workers, nurses, and other health professionals. (Note: Alleyne has been embattled for several months following the late 2006 deaths of more than 60 Panamanians from contaminated GOP-produced medicines. He has also taken heat for promoting Cuba's "Operation Miracle" program in Panama and for a controversial healthcare system reform proposal. End note.)

Despite Challenges, Torrijos Enjoys Solid Approval

¶15. (SBU) Since taking office for a five-year term in September 2004, the Torrijos government set its principal priorities as canal and maritime security, economic development, job creation, poverty alleviation, investment, fiscal reform, and "eradicating corruption." Torrijos faced large challenges from the outset: a serious budget shortfall; a near-bankrupt national retirement and medical system (the Social Security Fund); and faltering public confidence in government institutions and the rule of law. Although pressures from entrenched interest groups slowed GOP fiscal reform efforts, Torrijos' 2005 fiscal reform package - together with tax revenues driven by impressive economic growth - brought the GOP into a fiscal surplus (0.5% of GDP) by early 2007, Panama's first such surplus in ten years.

¶16. (SBU) Midway through his term, Torrijos enjoys high public approval ratings (over 60%) despite weathering bruising battles over fiscal and social security reforms, the Canal referendum, crises in healthcare and transport sectors, and having little to show for his promise to eliminate corruption. His Revolutionary Democratic Party (PRD) controls Panama's unicameral National Assembly and other governmental institutions. With opposition parties remaining fractured and so far unable to coalesce into an effective counterweight, the PRD appears well positioned to control Panama's political agenda going into the 2009 elections. As Torrijos is constitutionally prohibited from a consecutive term, various PRD members - including former President Ernesto Perez Balladares, First Vice President/Foreign Minister Samuel Lewis Navarro and his cousin,

the Mayor of Panama City Juan Carlos Navarro- have already begun to jockey for position as the PRD's 2009 candidate.

Panama Active on Global and Regional Stage

¶17. (SBU) In late 2006, Panama emerged as Latin America's consensus candidate for a two-year seat on the UN Security Council. This followed a prolonged deadlock between Venezuela and Guatemala. Faced with a steep learning curve at the UNSC, Panama has thus far played a responsible and constructive role. Panama will also host the Organization of American States (OAS) General Assembly in June 2007, which will focus on "energy for development." President Torrijos has pursued a policy of maintaining friendly relations with all nations, including hemispheric neighbors such as Cuba and Venezuela.

Good Cooperation on Security & Law Enforcement

¶18. (SBU) As a key link in the global supply chain and a vital transit point for U.S. trade (about two-thirds of the Canal's traffic is bound to or from the U.S.), the Canal presents an attractive and vulnerable terrorist target. Moreover, despite significant progress, Panama continues to be an important transit point for drug smugglers, money launderers, illicit arms merchants, and undocumented immigrants heading north thanks to its proximity to drug-producing neighbors and its status as an important, dollarized, financial center. With USG assistance, Panama has strengthened its ability to detect illegal money and narcotics shipments through Tocumen International Airport. Several GOP agencies participate as part of a Joint Task Force that averages several seizures of narcotics and/or money each week. For example, Embassy law enforcement agencies and the Task Force recently conducted two joint operations that seized at total of \$1.5 million in cash and gold. In March 2007, Panamanian authorities, with critical USG law enforcement support, conducted the largest ever maritime narcotics seizure on the Pacific Coast of Panama. Authorities confiscated a ship containing approximately 20 tons of cocaine with an estimated value of \$500 million. A USG built checkpoint near the Costa Rican border that is manned by various GOP agencies has also made consistent narcotics seizures and interdictions of undocumented aliens.

¶19. (SBU) The GOP recognizes that securing the Canal requires a mature, collaborative bilateral relationship. The Torrijos government is focused on Canal and maritime security and combating terrorism and transnational crime, although it has not yet found the resources to adequately patrol Panama's long Caribbean and Pacific coastlines and to secure Panama's porous border with Colombia against guerrilla infiltration. The GOP is moving ahead with plans to merge its National Maritime Service and its National Air Service into a single "Coast Guard" type of operation. U.S.-Panamanian cooperation in law enforcement and security has steadily improved in recent years. This has led to increasing narcotics seizures, better investigations, active maritime law enforcement, more specialized units, and better detection of money laundering and illicit financial flows. While the USG-GOP relationship is good, Panama's law enforcement institutions are weak and suffer from limited resources and professionalism.

¶20. (SBU) The GOP is acting to end abuses in Panama's open ship registry and mariner identification documents. Panama's ship registry, the world's largest, comprises one-quarter of the world's ocean-going fleet (over 5,000 large commercial vessels). About 13% of the U.S. ocean-going cargo transits the Canal each year. Panama's seafarer registry currently licenses over 300,000 crew members. Port services have grown dramatically in the past decade, as Panama now boasts the leading complex of port facilities in Latin America. In February 2007, the GOP and U.S. Department of Homeland Security executed a "Container Security Initiative" agreement aimed at enhancing the security of container traffic between our two countries. CSI equipment will first be installed this June at the U.S.-run Manzanillo International Terminal (MIT) in Colon.

Eaton